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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 356

WINTER REALTY & CONSTRUCTION CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 13-45) is reported at 2 T. C. 38. A memorandum (R. 47-51) accompanying an order of the Tax Court denying the Commissioner's motion to vacate and modify its opinion is not reported. The opinion of the Circuit Court of Appeals (R. 105-112) is reported at 149 F. 2d 567.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 23, 1945. (R. 112-113.) The

petition for a writ of certiorari was filed on August 22, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Circuit Court of Appeals erred in affirming the decision of the Tax Court that the taxpayer had not, within the meaning of Section 112 (f) of the applicable Revenue Acts, established a replacement fund and that, accordingly, it could not postpone the taxation of the entire gain realized by the taxpayer when its property was taken in a condemnation proceeding.

2. Whether the Circuit Court of Appeals erred in reversing the Tax Court and in holding that the Tax Court had erroneously construed the provisions of Section 112 (f) of the Revenue Act of 1936 with respect to the manner in which that section provides that gain is to be taxed.

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and Regulations involved are set out in the Appendix, *infra*, pp. 19-26.

STATEMENT

The following are the facts which were found by the Tax Court (R. 15-33):

Taxpayer is a corporation with its principal office in Flushing, New York. Its tax returns,

which were made on the accrual basis, were filed with the Collector at Brooklyn, New York, for the years here in controversy. (R. 15.) On November 4, 1931, the City of New York, as a result of condemnation proceedings previously instituted, acquired title to certain property which had been owned by the taxpayer and which consisted of improved real estate. (R. 16, 18-19.) The amount of the awards with respect to certain of the parcels was in litigation; as a result, taxpayer received payments on the awards during the years 1932, 1935 and 1936. (R. 17-18.)

The amounts of the award payments (less collection fees and special assessments) received by taxpayer were as follows (R. 17, 48):¹

1932	\$160,292.81
1935	125,735.57
1936	101,116.25
Total	387,144.63

Taxpayer realized capital gain on account of the condemnation awards as follows (R. 17):²

1932	\$23,527.98
1935	125,735.57
1936	101,116.10
Total	250,379.65

¹ These figures include an award of \$200 received in 1932 which the Commissioner did not include in the taxpayer's income for that year. Also, the Commissioner included, in 1936, fifteen cents less than the amount actually received. No issue was raised before the Tax Court respecting these discrepancies. (R. 17, fn. 1.)

² These figures show the gain as calculated by the Commissioner. See fn. 1, *supra*.

In 1932, taxpayer's manager went to the revenue office in Brooklyn and secured application blanks to establish a replacement fund. The application, which was not accompanied by a completed bond, was filled out in triplicate and mailed to the Brooklyn office. Later, through a representative, taxpayer made inquiry concerning the application, but it was never located. That application was not acted upon by the Commissioner. (R. 19.)

In closing its books for 1932, taxpayer set up on the liability side of its ledger an account entitled "Replacement Fund" in the amount of \$160,292.96. This, except for a discrepancy of fifteen cents, represented the total of three award installments received in 1932, less the collection fees paid in that year. (R. 19.)

When filing its tax return on March 15, 1933, taxpayer addressed a letter to the Collector at Brooklyn which pointed out that in the return there was a figure entitled "replacement fund" which represented 60 per cent of the City's appraisal of the amount of the award which had not yet been fully paid. (R. 19-20.) The letter continued (R. 20):

It is the intention of * * * [the] corporation, upon receipt of the balance of the award, to replace same in property in similar or related in service, or use of the property so converted; or, in the acquisition of control of corporation owning such other property.

In 1935, taxpayer increased the amount of the account captioned "Replacement Fund" from \$160,292.96 to \$291,451.72, this increase representing the net amount of the award installment received in 1935. A similar increase was made in 1936 to reflect the amount received in that year. (R. 21.)

On February 3, 1937, taxpayer filed with the Commissioner of Internal Revenue an "Application to Establish a Replacement Fund" on Form 1114. It did not refer to the prior application made in 1932. The application stated that the kind of replacement intended was "Offices, stores and apartments". It indicated as steps already taken "proceeds partially reinvested—buildings now under construction". Also, the application stated that 1937 was the date replacement would be completed. (R. 22-23, 65-66.) The application was accompanied by a surety bond which was not signed. (R. 23.) This application has never been approved by the Commissioner and the surety bond has never been completed. (R. 23.)

On February 19, 1937, the Commissioner addressed a letter to taxpayer which acknowledged receipt of the application and stated that it was being referred to the Internal Revenue Agent in Charge at Brooklyn, New York, for verification and comment and that upon receipt of his report the matter would receive prompt attention. (R. 23-24.)

The taxpayer did not segregate or set apart the award money when received. Instead, the money was deposited in taxpayer's general bank account along with the money it received from other sources. Checks against the account were drawn, from time to time, during the years in question, for payment of the replacement properties acquired and also for the payment of taxpayer's obligations of every kind, including current expenses, dividends, and expenditures for capital investment. (R. 26.)

Out of the award money received in 1932, taxpayer spent \$45,713.94 for the acquisition of other property similar or related in services or use to the property condemned. (R. 26.) No part of the award money received in 1935 was so expended. Of the award installment received in 1936, \$51,116.25 was used for the acquisition of replacement property. (R. 26.) The total amount thus expended was \$96,830.19. (R. 26.)

On November 8, 1935, taxpayer purchased a mortgage for \$150,000. This purchase, to the extent of \$125,735.57, was made from the award money received November 7, 1935. On May 4, 1936, taxpayer purchased another mortgage for \$50,000. This purchase was made out of the award installment received on May 4, 1936. Both mortgages are outstanding. (R. 21.) These mortgages appeared in taxpayer's balance sheets as an asset under "Mortgages Receivable." (R. 21, 22.)

The taxpayer, in filing its tax returns for the years in question, did not report any part of the realized gain in its net income.

On March 6, 1941, the Commissioner mailed to the taxpayer a notice of deficiencies in income and excess profits tax resulting from, among other things, the failure of taxpayer to have included in its returns the capital gain realized in the years and in the amounts set forth above. The deficiency notice stated that the realized gain was required to be recognized because the taxpayer had not forthwith expended the proceeds of the award in the acquisition of other property similar or related in service or use to the property condemned, or in the acquisition of control of a corporation owning such property, or in the establishment of a replacement fund, in accordance with the provisions of Section 112 (f) of the applicable Revenue Acts. (R. 16, 24.)

The taxpayer sought a redetermination of the deficiencies before the Tax Court. The Tax Court found that a replacement fund had not been established but that a portion of the award money had been expended in the acquisition of replacement property, as shown above. It determined that gain was to be recognized in the following amounts (R. 41, 48):

1932	-----	\$23, 527. 98
1935	-----	125, 735. 57
1936	-----	50, 000. 00
Total		-----
		199, 263. 55

The deficiencies in taxpayer's income and excess profits tax resulting from the conclusions of the Tax Court respecting this issue (and resulting from other issues decided by the Tax Court which are not now presented) were entered in the decision of the Tax Court dated September 9, 1943. (R. 52-54.)

The Commissioner, by petition for review filed December 7, 1943, sought review by the Circuit Court of Appeals of the Tax Court's decision insofar as it ruled that the amount of gain to be recognized in 1936 was \$50,000 rather than \$101,116.10, as determined by the Commissioner. (R. 2, 3-6.)

The taxpayer, by petition for review filed December 9, 1943, sought review of the Tax Court's decision in its holding that any part of the gain was required to be recognized. (R. 2, 7-12.) The cross appeals, by stipulation of the parties, subject to the approval of the appellate court, were consolidated for review.

The Circuit Court of Appeals affirmed the decision of the Tax Court in its holding that the taxpayer had not established a replacement fund and that the recognition of no part of the gain could be postponed on that account. It reversed the decision of the Tax Court so far as it held that Section 112 (f) of the Revenue Act of 1936 required that only a portion of the gain realized in that year be taxed. (R. 105-112.)

ARGUMENT

1. The first issue framed by the petition for certiorari (p. 7) seeks review of a question whose resolution would not be decisive of this case. Further, the absence of any conflict in decisions and the unimportance of the question require that the petition be denied.

The question, as it is stated by the taxpayer, is (Pet. 7)—

may the Commissioner, by ignoring applications filed pursuant to the Regulations, prevent the taxpayer from establishing a replacement fund where such fund is otherwise properly established?

As will be shown, however, the assumption that the fund was otherwise properly established is directly contrary to what was decided below. Also, as it is stated by the taxpayer, the question ignores the fact that even if the Commissioner had actually granted the applications, the circumstances of this case would still have prevented the taxpayer from postponing the taxation of the gain which it had realized.

The decision of the Tax Court actually removed any objection which the taxpayer reasonably could voice respecting the failure of the Commissioner to grant permission for the establishment of a replacement fund. That is, the Tax Court decided

the case "as if" authority to establish the fund had been obtained from the Commissioner. Even on that assumption, the Tax Court was impelled to conclude that the taxpayer did not in fact proceed to use the award money to establish a replacement fund. Thus, even if the Commissioner had actually authorized the establishment of a replacement fund, the taxpayer's failure to do so inevitably leads to the conclusion that the gain which it realized was required to be recognized for tax purposes precisely as the courts below held.

The taxpayer's contention that it had established a replacement fund rested on two alternative arguments. First, it asserted that all the award money was invested in such a fund because it had entered a bookkeeping liability on its balance sheets in that amount and contended that it was not necessary that identifiable assets exist which would balance the entry and which had been acquired with the award money for the purpose of ultimate investment in replacement property. The Tax Court rejected this argument. (R. 38.)

The taxpayer's second contention was that it had invested in a replacement fund, at least to the extent that a portion of the award had been invested in certain real estate mortgages. The Tax Court ruled against this argument, too, hold-

ing that these particular mortgages had "no relation to a replacement fund" and that they had "not been designated in any way as representing a replacement fund." (R. 38.) The Tax Court also observed (R. 38):

Furthermore, mortgages would probably not be regarded as an ideal investment for the purpose of a replacement fund of this character because they might not be readily convertible when the time for actual replacement arrived.

The decision of the Circuit Court of Appeals has been altogether misconceived by the taxpayer. It did not decide the case "*solely* because the Commissioner of Internal Revenue had not given permission to establish the fund", as the petition asserts (p. 6), and its opinion cannot be construed as having (Pet. 5) "inferentially disapproved the main ground of the Tax Court's decision, namely, that real estate mortgages were not a proper investment for a replacement fund."

Nowhere does the opinion of the Circuit Court of Appeals show any disagreement with the reasons advanced by the Tax Court for its decision on this issue. The court below merely expressed additional reasons why the Tax Court's decision was required to be affirmed; it did not, in any way, express doubt respecting the validity of the grounds relied on by the Tax Court. Thus, the

Circuit Court of Appeals, by specifically pointing to the requirements of the Regulations that the compensation must be held in a fund and by upholding their validity against the taxpayer's objections, denied the taxpayer's contention, vigorously renewed on appeal, that its book entries alone were sufficient to constitute a replacement fund.

We also deny that the Circuit Court of Appeals rejected the Tax Court's conclusion that the taxpayer had not, as a matter of fact, invested a portion of the award money in mortgages with the intention that they serve as a temporary investment to be used ultimately for the acquisition of replacement property, or that it overruled the finding that, in this case, the mortgages did not have any relation to the replacement fund. Nor did the court below inferentially disapprove the Tax Court's additional observation (which the taxpayer exalts as being "the main ground" of the Tax Court's decision (Pet. 5)) that real estate mortgages would probably not be an ideal investment for a replacement fund. The Circuit Court of Appeals did not decide that these mortgages were a proper investment or that they did constitute a replacement fund; it only stated that, even if they were proper assets, the taxpayer would still be unable to prevail on account of the additional reason set forth in its opinion, namely,

that the Commissioner actually had not given permission for the establishment of any fund. In this respect, the Circuit Court of Appeals stated (R. 108):

The form of the "fund" is not prescribed, and, *arguendo*, we may assume that entries upon the owner's books, such as the taxpayer here carried, if supported by bank deposits, or mortgages, would be permissible.

It should be noted that by inadvertently omitting the word "*arguendo*" from the above quotation, (Pet. 5-6), the taxpayer has fallen into the error of confusing an assumption which the court made only for the sake of discussion, with an express holding in the decision.

Since the basis for the decision of the Tax Court stands unchallenged either by the petition for certiorari or by the opinion of the Circuit Court of Appeals, it must be apparent that the taxpayer is seeking review of an academic question. Even if the additional ground advanced by the Circuit Court of Appeals were erroneous, the decision below would still require affirmance on the reasons given by the Tax Court and which are not now brought forward in the petition for certiorari as furnishing a basis for further review.

The question which the petition presents is academic for yet another reason. The Commissioner's non-action could not be held, under any theory, to give the taxpayer the right to establish a replacement fund in any broader terms than the taxpayer itself requested. In its application to establish a replacement fund, the taxpayer represented that it would complete the acquisition of replacement property in 1937. (R. 22-23, 37, 66.) If the Commissioner had granted the application, the taxpayer would not have had permission to establish the fund for any longer period or to delay the acquisition of replacement property beyond 1937. Quite clearly, the taxpayer is not entitled to be in any better position today than it would have occupied if the application had been granted as requested. Yet, except to the extent specifically found by the Tax Court (R. 41-42), the taxpayer had not acquired the replacement property by April, 1942, the date of the hearing before the Tax Court. Thus, even if the taxpayer's application had been granted in the terms requested, its failure to acquire replacement property long after the expiration of the permission would require that the gain be taxed.

In addition, it may be observed that the redetermination of a tax deficiency under Section 272 of the Internal Revenue Code is scarcely an appropriate proceeding in which to test the right of a

taxpayer to secure administrative consideration of his application to establish a replacement fund. Mandamus might have been seasonably applied for to that end; but even in that event the writ could not have been used to order the Commissioner to exercise his discretion in a particular manner or to compel him to grant the application. *I. C. C. v. United States*, 289 U. S. 385, 394; *Wilbur v. United States*, 281 U. S. 206, 218.

No conflict in decisions exists. The issue presented for review is not only not decisive of the case, but is unimportant as is evident from the fact that this problem appears to be unique in the 24-year history of the administration of similar provisions in all Revenue Acts, beginning with the Revenue Act of 1921. Moreover, the Circuit Court of Appeals properly affirmed the decision of the Tax Court that the taxpayer had not, within the meaning of the statutes and the regulations, established a replacement fund.

2. The Circuit Court of Appeals did not exceed its powers of review under Section 1141 (c) of the Internal Revenue Code by reversing the Tax Court for having determined the taxpayer's taxable gain in an erroneous manner.

Section 112 (f) of the applicable Revenue Acts (Appendix, *infra*) deals expressly with the extent to which gain realized on an involuntary conversion should be recognized for tax purposes when

the proceeds have been partially reinvested in replacement property. The Tax Court believed "that it was the intent of the statute" (R. 49) that where a single condemnation award is paid in installments over several years, the amount of gain subject to tax should be different than it would have been if the entire award had been paid in one taxable year. Accordingly, the Tax Court, in determining the amount of the taxpayer's gain to be recognized on the receipt of each installment of the award, felt that it was obliged by Congress to refuse to take notice of how much of the money, represented by the previous installments of the award, had not been expended in the purchase of replacement property. The Circuit Court of Appeals, however, held that such a construction of Section 112 (f) was erroneous and that Congress did not intend such a result.

We believe it quite plain that the construction of the statute adopted by the Tax Court was not a permissible one. We also believe that the reasoning of both the majority and concurring opinions in *Trust u/w of Bingham v. Commissioner*, decided by this Court June 4, 1945, not yet reported, supports the position that such a construction of the statute is subject to correction on review.

The decision of the court below does not depart from *Dobson v. Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231, with which the

taxpayer asserts a conflict. (Pet. 8, 14.) In the *Dobson* case it was the absence of any governing provision of a statute or regulation which led this Court to conclude that the Tax Court had discretionary authority under Section 272 (f) of the Revenue Act of 1928 to determine from prior years whether the taxpayer there had a return of capital or received ordinary income. It was expressly recognized, however (pp. 492-493), that if the method employed by the Tax Court in the *Dobson* case had been forbidden by the applicable statutes and Regulations, its—

decision would not be “in accordance with law” and the Court would be empowered to modify or reverse it. Whether it is true [that the applicable statutes and regulations properly interpreted forbid the method followed] is a clear-cut question of law and is for decision by the courts.

If, as the Circuit Court of Appeals held, Section 112 (f) itself requires the Tax Court to determine taxable gain in one particular manner, then there is no choice about methods and the Tax Court does not possess any discretion whether it will or will not inquire into previous years. The very reasons why the Tax Court’s exercise of discretion was considered to be entitled to finality on review in the *Dobson* case do not exist in this situation. Whether Section 112 (f) is or is not an applicable statute forbidding the method of de-

termination employed by the Tax Court is, as pointed out in the *Dobson* case, a clear-cut question of law for decision by the courts on review.

CONCLUSION

For the reasons expressed above, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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